Lessons from the Past: Determining the Extent of Protectionism in the United States amid the Great Trade Collapse of 2008-2009

A Senior Honors Thesis

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by

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INTRODUCTION

The economic downturn of 2008-2009 has led to the current trade situation known as the "Great Trade Collapse", an extensive downfall in world trade. At a world trade reduction of over 12 percent, the Great Trade Collapse is the highest rate of trade contraction since 1945(Escaith et al., 2010; Baldwin, 2009). The large-scale nature of the economic downturn has been examined by various economists, many of whom cite the role of global supply chains in facilitating the rapid spread of the global recession (Escaith et al., 2010; Baldwin, 2009). While the particular causes of the recession vary, many economists suggest that the epicenter of the global recession is the United States. The fall of Lehman Brothers that occurred as part of the sub-prime mortgage crisis subsequently triggered a worldwide response.

In his speech before World Trade Organization (WTO) members in February 2010, WTO Director-General Pascal Lamy expressed the need for continuing trade negotiations under the long-lasting Doha Round and for recognizing the importance of trade as a buffer against the global recession, both in the short-term and long-term. He emphasized that many of the 200 million jobs lost worldwide can be recovered if WTO members maintain their commitment to trade and avoid protectionist and retaliatory measures (*Council on Foreign Relations*).

Trade protectionism during a recession is not an uncommon phenomenon, and many governments facing political pressure to "save" domestic jobs often practice it. Trade theory unambiguously shows, however, that trade provides a net benefit to the domestic economy and helps the consumer. Still, the rent-seeking efforts of industries facing foreign competition often, at the expense of the American consumer, concentrate these benefits on a small percentage of industries by hindering trade with foreign competition. While political leaders may understand that protectionism is not beneficial for the country as a whole, there have been several political initiatives and public efforts that are indeed protectionist, such as the bills introduced in Congress aimed at overhauling the establishment of trade negotiations. Many members of Congress are demanding stricter labor and environmental regulations as well as limiting the role of the WTO when proceeding with future trade negotiations. For example, Senator Sherrod Brown (D-OH) in the Senate and Representative Mike Michaud (D-ME) in the House, have introduced the 2010 version of the Trade Reform, Accountability, Development, and Employment (TRADE) Act.[1] The TRADE Act demands revisions of the pending trade agreements with Panama, Korea and Colombia, as well as with other established trade agreements, such as the North American Free Trade Agreement (NAFTA), and future trade agreements.

The Obama Administration has made some effort to encourage trade negotiations and trade expansion despite the current political climate. These measures include establishing the Export Initiative and supporting the ratification of the pending trade agreements. Secretary of State Hillary Clinton and United States Trade Representative Ron Kirk have concurred that the pending free trade agreements with Colombia, Korea, and Panama could be ratified by the end of 2010. Nevertheless, with the political pressure from Congress, any and all trade negotiations may be delayed for quite some time, including agreements formed under the Doha Round.

The apparent misalignment in United States trade policy during a recession is a representation of the polarized actions between Congress, the Presidential Administration, and the American public in resolving the issues of an economy facing falling output and rising unemployment. With the Great Trade Collapse as a result of one the largest recessions since the

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[1] The 2008 TRADE Act could not pass into law when the 110th Congress closed. According to GovTrack.org, "At the end of each session all proposed bills and resolutions that haven't passed are cleared from the books. Members often reintroduce bills that did not come up for debate under a new number in the next session."

1970s and the WTO in danger of losing some clout with the languishing Doha Round, the next steps taken by Congress and President Obama have the potential of significantly changing trade policy, for the better or worse.

In this paper, divided into three segments, I will explore the underlying political issues occurring during a recession to define the impact a recession has on US trade policy. By first examining previous trends in US trade policy during a recession, such as the infamous Hawley-Smoot Tariff Act, I will provide key insight into factors that will be at play during the current recession. Then I will assess current trade policy pursued by Congress and by the Administration to determine whether the US has succumbed to protectionism, despite the strides towards freer trade. Using the historical progression of trade policy, one can more accurately characterize the recent efforts by politicians to develop an advantageous trade strategy while considering the US's role in a multilateral trading system. Lastly, I will examine the relationship between US trade policy and the Doha Round, which will serve as an illustration of the US commitment to free trade while facing an agenda of reviving the US economy.

I. PERSPECTIVE ON US PROTECTIONIST MEASURES AND THE POLITICAL ECONOMY

The United States has long been recognized as the lead proponent in *laissez-faire* policy, though this has not always been the case. In 1791, Alexander Hamilton, the first US Secretary of State, proposed that Congress protect the manufacturing sector from British competition by imposing high tariffs. Hamilton argued:

> To maintain, between the recent establishments of one country, and the long-matured establishments of another country, a competition upon equal terms, both as to quality and price, is, in most cases, impracticable. The disparity . . . must necessarily be so considerable, as to forbid a successful rival ship, without the extraordinary aid and protection of government.

Hamilton's request for infant industry protection was granted. Deemed the "Hamilton tariffs", the US manufacturing industry developed behind tariff barriers that reached up to 40 percent but never below 25 percent (Elliot, 2005). The tariffs allowed the government to earn revenue, yet Hamilton's appeal for infant industry protectionism proved insignificant in expanding the US manufacturing sector's growth. Moreover, though the Hamilton's request was for new industries, tariffs for the expansion of industrialization in the North continued well into the 19th century.

Such tariffs were controversial since they provided benefits to the industrial North at the expense of the agrarian South. The Tariff of 1828, also known as the Tariff of Abominations, for example, served as a bone of contention between the North and the South, and was one of the many factors leading to the Civil War. Leaders from the South argued that tariffs increased the prices of British goods and caused the prices of their agricultural goods to increase, thereby reducing profits in the South.

Bartlett states that the Republican Party introduced all major legislation encouraging tariffs during the late 18th and early 19th century. The Republican Party, created in 1854, was strongly aligned with the North and its industrial expansion. It was not until the Underwood tariff of 1913, signed by President Woodrow Wilson, a Democrat, that there was an attempt to reduce tariffs. Nevertheless, with Republicans assuming power after World War I, tariffs were raised again with the Fordney-McCumber tariff of 1922 designed to protect manufacturing firms.

The Fordney-McCumber tariff of 1922, though highly protectionist for raising tariffs by almost 40 percent, provided the first fundamental change to US trade legislation. Until the Fordney-McCumber Act, Congress had the exclusive power in formulating trade policy and trade negotiations. The Fordney-McCumber Act provided the President with the ability of either reducing or increasing tariffs by 50 percent when negotiating with countries for the purpose of helping domestic industries. However, the President could only establish these negotiations when recommended by the Tariff Commission, a congressional oversight committee.

Bartlett shows that the tariffs of the 18th and early 19th century were not detrimental to the United States because exponential economic growth offset the negative influence of tariffs. According to his essay, the increase in immigration during this era and the rise of industries in which the United States had a comparative advantage, such as cotton and textiles, allowed the United States to grow despite tariffs. Congress continued to support tariffs in both times of prosperity and economic downturns during the 18th and early 19th centuries. The notion that tariffs could be used to complement growth defined America's position on international trade until after the Great Depression of the 1930s.

The Tariff that Caused a Trade War

After World War I, the United States and other countries experienced a rare economic boom known as the "Golden Age". Studies by Bairoch show that from 1913 to 1920, economic growth for developed countries was, on average, -1.3 percent, in part because of the war. Between 1920 and 1929, the average growth rate was 3.1 percent.

In 1928, Herbert Hoover ran his campaign as the Republican candidate. Despite the US experiencing economic prosperity, his stance on domestic industry and trade was highly protectionist. He stated in one of his campaign speeches:

> We realize that there are certain industries which cannot now successfully compete with foreign producers because of lower foreign wages and a lower cost of living abroad, and we pledge the next Republican Congress to an examination and where necessary a revision of these schedules to the end that American labor in these industries may again command the home market, may maintain its standard of living, and may count upon steady employment in its accustomed field (*Republican Platform of 1928*).

Hoover's speech reflects an isolationist approach to trade and the American public's desire to obtain dominance in all aspects of their domestic market. In keeping his promise, in June 14, 1929, Hoover signed yet another bill that raised tariffs to protect domestic businesses.

The prosperity of the 1920s ended soon thereafter. Only a few months later, the stock market crashed.

The Great Depression began on October 29, 1929 with the stock market crash, known as Black Tuesday, and the subsequent bank runs. With a broken financial market, and without institutions to ease the crisis, the recession quickly became a depression. The unemployment rate reached 24 percent, a major sign that domestic industries were failing (O'Brien, 2001).

Politicians were faced with the pressure of sustaining American industries and employment. Increasing tariffs seemed a direct solution. As in the past, politicians resorted to tariffs in an attempt to save the domestic market. Without considering the repercussions, the House of Representatives overwhelmingly supported the Hawley-Smoot Act introduced by Representative Willis Hawley (R-Oregon) and Senator Reed Smoot (R-Utah), which allowed tariffs to reach an all time high. The Senate, on the other hand, supported the bill only by a small margin (O'Brien, 2001). Hoover signed the Hawley-Smoot Act, though one thousand leading economists petitioned Hoover to veto the Act, stating that increasing tariffs would limit growth and worsen the recession. The misconception that surrounded tariffs, however, allowed for the warning to be ignored (O'Brien, 2001).

The Hawley-Smoot Act allowed Congress to establish "made-to-order" tariffs for whichever industry desired to protect their business (Bhagwati, 1988). For manufacturing goods, tariffs rose to an average near 50 percent, with some reaching rates of 100 percent (Bartlett, 2009).

The misconception that tariffs would encourage growth in the recession proved very detrimental. Many argue that the Hawley-Smoot Act was an important factor in turning the recession into the Great Depression by encouraging a global trade war.

Richard Bedford Bennett, a Conservative candidate in Canada, called for retaliatory measures to offset the United States' tariff increase. In his speech, he proclaimed:

> How many thousands of American workmen are living on Canadian money today? They've got the jobs and we've got the soup kitchens? I will not beg of any country to buy our goods. I will make [tariffs] fight for you. I will use them to blast a way into markets that have been closed (O'Brien, 2001).

Many countries retaliated by increasing tariffs on US goods. Great Britain and Canada were particularly assertive, raising countervailing duties to the same extent of American tariffs.

The intention of the Hawley-Smoot Act was to strengthen domestic industries and protect the agricultural sector from competition. Instead, as trade theory suggests, the increasing cost of domestic goods and products had a negative effect on consumers and producers. With domestic consumption down, unemployment continued to increase as many domestic industries went out of business. The Hawley-Smoot Act undoubtedly contributed to the worsening of the depression, and high tariffs, finally, were seen as a damaging and unproductive means of expanding domestic economic growth.

The Move towards Trade Expansion

The election of 1932 brought to light the weakness of the Hoover administration in overcoming the recession. Franklin D. Roosevelt, the Democratic candidate, emphasized as part of his political campaign that the high tariffs imposed by the Hoover Administration, among other things, worsened the depression and resulted in the high unemployment rate of the time. Many Americans bitter with the Hoover Administration agreed and therefore elected Roosevelt hoping for some relief from the Great Depression.

As part of his agenda, Roosevelt established foreign policy that was unlike the isolationist decree of his predecessor. Early in his term, Roosevelt signed the 1934 Reciprocal Trade Agreement Act, which reduced tariffs and encouraged trade negotiations with other countries. The Roosevelt administration successfully convinced Congress that trade policy transformed into a political game with significant consequences for the American consumer. As such, in this monumental legislation, the authority to determine tariffs and the rate of protection shifted from Congress to the President. This institutional shift "imparted a powerful anti-protectionist thrust to US policymaking" (Bhagwati, 1988).

The Reciprocal Trade Act proved beneficial in expanding world trade by providing a basis for the General Agreement on Tariffs and Trade (GATT). The GATT, formed as part of the international negotiations at Bretton Woods, is based on the two pillars of nondiscrimination and reciprocity (Bagwell and Staiger, 1999). As a multilateral effort to solidify a global economy, the

GATT was instrumental in encouraging a worldwide reduction in tariffs, particularly in manufacturing.

The GATT formed the interim committee for the International Trade Organization. But due to disagreement on establishing a international system for dispute resolution on issues of trade, the interim committee lasted over fifty years until the establishment of the WTO, chartered in 1995. Since the GATT was formed and the WTO established, over 100 countries have become members of the multilateral trading system. With more countries as members, the GATT and its successor the WTO have the potential of effectively reducing worldwide tariffs through the Most Favored Nation (MFN) clause and a sequence of trade rounds.

One of the most important elements of the multilateral trading system was the removal of the inconsistency of tariff increases that resulted from political pressures faced during economic downturns. As stated:

> The principle of reciprocity has the effect of neutralizing the world-price effects of a government's decision to raise tariffs, and so it can eliminate the externality that causes governments to make inefficient trade-policy choices (Bagwell and Staiger, 1999, 218).

Following the establishment of the GATT, the world then experienced a golden era of trade liberalization from the 1950s through the early 1970s; world income increased by 4.3 percent and world trade by 6.1 percent. (Bhagwati, 1988). Within the US, the Reciprocal Trade Act of 1934 and the GATT transformed US trade legislation into attempts at trade promotion rather than protectionism. Membership in a multilateral system provided more incentive for the trade policy structure to include mediation and international oversight rather than inefficient unilateral measures.

However, early on, the GATT did not have the transnational authority to hold countries accountable for protectionist measures, since many signatory countries viewed it as nothing more than an agreement as opposed to a binding system with consequences for those countries that fail to oblige. In the US, many members of Congress deemed the GATT ineffective in resolving trade disputes due to its lengthy process. Negative criticism rose especially during the recession of the 1970s. Again, with firms facing tough foreign competition, Congress attempted to strengthen the domestic industry through trade measures. Therefore, Congress passed Section 301 as part of the Trade Act of 1974, one of the most aggressive clauses to US trade legislation after creation of the GATT.

Section 301: A Step Back

The 1970s US recession was characterized by “stagflation”, which is a high rate of unemployment combined with inflation, which was a consequence of monetary policy and the increase in oil prices. Labonte and Mankinen note that though the US has relatively little reliance on international trade and, due to its economic strength, can be immune to the macroeconomic instability of other smaller countries, the increase in oil prices served as a surprising shock to the aggregate supply of the US economy. Still, Lebonte and Manikin (2002) find that inflation had risen unsteadily before the drastic increase in oil prices, and combined with “a secular decline in US-productivity that lasted 20 years”, the US fell into a deep recession. They also attribute the government’s policy of price and wage control in exacerbating the recession (Lebonte and Manikin, 2002).

The recession of the 1970s was the first global recession since the Great Depression. With regard to international trade, one difference between the Great Depression and the “stagflation” of the 1970s was the multilateral trading system. The United States had been part of six multilateral trade rounds at this point, and seemed fully engaged in trade negotiations.

Moreover, the US established the office of the United States Trade Representative (USTR) as part of the Trade Expansion Act of 1962. The multilateral trading system seemed promising, but the recession of the 1970s stood as the first test of its efficacy.

During the 1970s, with productivity already declining in the manufacturing sector, competition with Japan proved exceptionally daunting. While many countries saw output decrease and unemployment rise at rapid rates, Japan was one of the few countries that saw growth, at an annual rate of about 5 percent a year (Jorgenson and Motohashi, 2003).

The political pressure faced by politicians to save the declining manufacturing sector from competition with Japan resulted in one of the most assertive trade bills since Hawley-Smoot. The 1974 Trade Act established Section 301 specifically aimed at protecting domestic industries from what it deemed as "unfair" foreign trade practices, allowing more authority (and pressure) for the President and the USTR to target other countries. In 1988 this measure was expanded to include an amendment requiring that the USTR create a regular list of countries practicing "unfair" trade measures (Behghin and Kherallah, 1998). Though the Reciprocal Trade Act of 1934 included Section 300, which allowed investigations into unfair trade practices, Section 301 allowed for tougher consequences including imposing trade sanctions. With the inception of the WTO, the US had legitimate oversight to address trade disputes, and trade sanctions are strongly disapproved under the WTO system.

The following recessions in the early 1980s and early 2000s were relatively mild compared to the Great Depression and the "stagflation" of the 1970s, especially with regard to international trade. Countries were able to recover more rapidly, allowing trade volume to increase shortly thereafter. Therefore, during the recessions of the early 1980s and early 2000s, there were no major pieces of trade legislation established as protectionist, other than the expansion of Section 301. However, this does not mean that the US did not raise tariffs or establish other protectionist measures. Trade remedies such as countervailing duties and antidumping measures increased in the late 1970s and the 1980s (Bhagwati, 1988). In the early 2000s, one of the most noteworthy protectionist measures was the implementation of tariffs on foreign steel, authorized by President George W. Bush. President Bush raised tariffs up to 30 percent to protect the steel industry that was integral to economies in the Midwest, such as Ohio and Pennsylvania (*Reuters*, 2002). However, Bush removed these tariffs after the WTO ruled them illegal (Hoffman, 2009).

Lessons from the Past

The history of US trade legislation provides insight to what to expect in the forthcoming years as the global economy continues recuperating. As economists often warn, recessions are used as an argument to encourage protectionism. However, from the onset of the Hamilton Tariffs to the Great Depression, we see tariffs increase despite the state of the economy, often being used to establish US dominance in the global market. After the Great Depression until today, tariffs are used to protect the domestic industry from "unfair" competition.

Studies looking into the leading factors that encourage protectionism are plenty, with many reaching the consensus that the political environment is a significant element in determining the extent of protectionism and the onset of a trade war. Kherallah and Beghin assert:

> "The likelihood of a trade war increases when the United States' export share in the world market declines, when the United States is less dependent on the market of the targeted country, when foreign policy makers are in an election year, and when negotiations relate to highly protected and unionized industries in the targeted countries" (1998, 1).

In general, heavy competition with a foreign market may lead less competitive sectors, which are often unionized or highly organized, to seek the support of politicians to protect them. The politicians, then in turn maximize their utility by amassing more votes from the members of the organizations.

As this historical perspective on trade legislation demonstrates, industries that need saving from foreign competition are often those that do not reflect the United States' comparative advantage. Tariffs in the United States, at first, served as infant-industry protection since the US lacked the endowments to procure a successful industrial society. The same story has carried into the modern era, and still determines which sectors receive the most government protection.

Currently, the agricultural and manufacturing industries receive the most protection from the US government. However, when the US had a comparative advantage in each industry, protectionism was less for each industry. This is evident in the 18th century when the agricultural sector received little tariff protection in its favor at the expense of the manufacturing industry. Despite being at a disadvantage, the agricultural sector did not require tariff protection to succeed. However, around the 1920s, the agricultural sector became less competitive when developing countries began opening their economy through their own agricultural sector, and therefore encouraged Congress to protect them. Under the Agricultural Adjustment Act of 1933, as part of the New Deal, the government established agricultural subsidies that removed some competition, increased the prices of agricultural goods, and protected the farming industry from fluctuations in prices.

Manufacturing industry has had a similar evolution in terms of protectionism. With tariffs directly benefiting industrialization that eventually served the US well, the removal of tariffs became a difficult task for Congress. It was not until the 1950s when manufacturing firms were supportive of reducing tariffs, and was the leading sector in overwhelmingly supporting the trade expansion acts introduced in the 1960s (Griswald, 2010). Supporting trade expansion reflected the reality that manufacturing firms were, at the time, competitive in foreign markets and therefore benefited from trade. With the demise of productivity in the manufacturing industry reaching its peak in the 1970s, Congress enacted legislation that would uncompromisingly seek the "wrongdoings" of foreign firms providing a basis for applying trade remedy measures.

The Stolper-Samuelson theorem maintains "factors of production in which a country is relatively scarce lose from trade… while abundant factors gain from trade" (Judkins and Milner, 2004). The development of the agricultural sector and the manufacturing industry in trade demonstrates this and what Bhagwati (1988) calls the Darwinian Doctrine, in which firms engage in trade when they are competitive and expect to be winners in the global market. Without trade barriers, loser firms cannot be expected to compete successfully in the global market. As Bhagwati so eloquently states, by competing with labor-intensive countries the "Stolper-Samuelson theorem becomes a dagger aimed at our unskilled workers' jugular" (2002). When such industries cannot be competitive in the foreign and domestic market because of the US's comparative advantage, seeking protectionist measures through the political process is the next step. The political party that is in the majority is often cited as an influential factor in determining which industries receive protection and to what degree.

Republicans in the 18th century were supportive of tariffs for manufacturing industry, which seems in contrast to Republicans today who are often seen as the supporters of freer trade. Today, Republicans are more likely to stand down from a trade war, and less likely to initiate protectionist measures. A study finds that overall Republicans in Congress appear to back down from following through on a trade sanction more often than Democrats after initiating Section 301, though both parties start the process of utilizing Section 301 at a rate of about five times a year (Beghin and Kherallah, 1998).

The Republican Party's shift from protectionism to freer trade and the Democratic Party's change to support protectionism, though not clear, has been linked to "the position of American labor in an increasingly open economy" (Judkins and Milner, 2004). Their study shows that the right-wing party in developed economies is often aligned with interests of capital, whereas left-wing parties are aligned with the interests of labor. Still, this alignment was not evident in the US until the 1970s when Democrats formed a strong alliance with unions, and supported protectionism for the declining manufacturing sector.

Beghin and Kherallah show that Democrats maintain a tougher stance when using Section 301 and are more likely to pursue trade sanctions when finding a country is practicing "unfair" trade. Often, countries that become targets for the trade sanctions are those that are strong competition against the highly unionized sectors, such as manufacturing firms. The current Democratic party, once a party that supported free trade and through Roosevelt's leadership can be recognized for encouraging a multilateral trading system, are now opposed to the very system that they helped establish.

Hoffman (2009) studied American public opinion in matters of trade policy through a survey including 100 questions on trade and globalization, and some of the findings are surprising and almost counterintuitive to what we have learned so far. Though politicians aim to reflect the support of their constituents and party members, people's opinion on trade policy and trade measures may not always reflect that of party affiliation. Hoffman finds that "party affiliation is not significantly related to [the publics'] opinions on 'globalization' or the promotion of free trade." Hoffman cites the most recent examples of President Clinton encouraging NAFTA and President Bush raising tariffs for steel in 2002. Hoffman finds that "despite the vilification by organized labor," American Democrats in the survey were generally pro-NAFTA. Republicans were also supportive of President Bush when he raised tariffs. In fact, the survey revealed that Republicans were 31 percent more likely than Democrats to believe that tariffs were the correct measure to pursue. "In short," Hoffman says, "attitudes on [issues of globalization and the promotion of free trade] may be influenced by political leaders, rather than long standing associations with party positions. Constituents may be more amenable to pointed appeals from party leaders."

Assuming that Hoffman's studies are reflective of the general American population, one must question what truly influences politicians to vote on measures with a pro- or anti-trade stance. If politicians aim to improve the welfare of all Americans, why would Congress ratify any protectionist measure, such as Hawley-Smoot or agricultural subsidies, which would reduce national welfare? Many studies point towards the rent-seeking behavior of special-interest groups that influence politicians to vote for or against measures that may be beneficial to that sector or organization in determining why some protectionist measures are passed.

Baldwin and Magee (1998) examined the degree in which special-interest groups influence politicians by studying the correlation between voting patterns and monetary contributions in regards to ratifying NAFTA and a 1994 agreement under the GATT. Both treaties provoked divides between business and labor; business organizations were for NAFTA and the GATT agreement unlike the labor organizations. Baldwin and Magee suggest that without monetary contributions from either sector, NAFTA and the GATT agreement would have passed. Still, studying the affects of contributions from business and labor organizations, the study revealed that 62 representatives that voted against NAFTA were influenced by labor organizations, and contributions from business organizations influenced 34 representatives to vote for NAFTA. The most significant finding of this study is that it provides support to the theory that votes by politicians are, indeed, "for sale" (Krugman and Obstfeld, 2009).

The history of trade legislation and studies on trade policy and the political economy illustrate that there is no direct way to predict the steps the US government may take during the current recession. However, we are provided with some key insight on the probable measures that will be undertaken, and the logic as to why certain measures have and will be taken. With a Democratic majority in Congress and a Democratic President, the upcoming Congressional mid-term elections in November 2010, which will take place during an economic slump, the next steps in trade policy are predicted to be protectionist. This is why the President's commitment to the multilateral trading system while leading the US in recovering from the recession will be crucial in determining the extent of protectionism for the next few years.

II. THE US RECESSION AND THE GREAT TRADE COLLAPSE OF 2008-2009

Currently, the US is trying to recover from a recession that parallels the greater recessions of the past. Similar to the Great Depression, the United States is at the center of a worldwide economic downturn, facing major unemployment as industries, especially in manufacturing, wane in the face of foreign competition.

There were various factors leading to the 2008 US recession that, at this moment, the US is still recovering from. It is known, however, that the two leading causes were an increase in sub-prime mortgages that led to widespread default and the house market bubble.

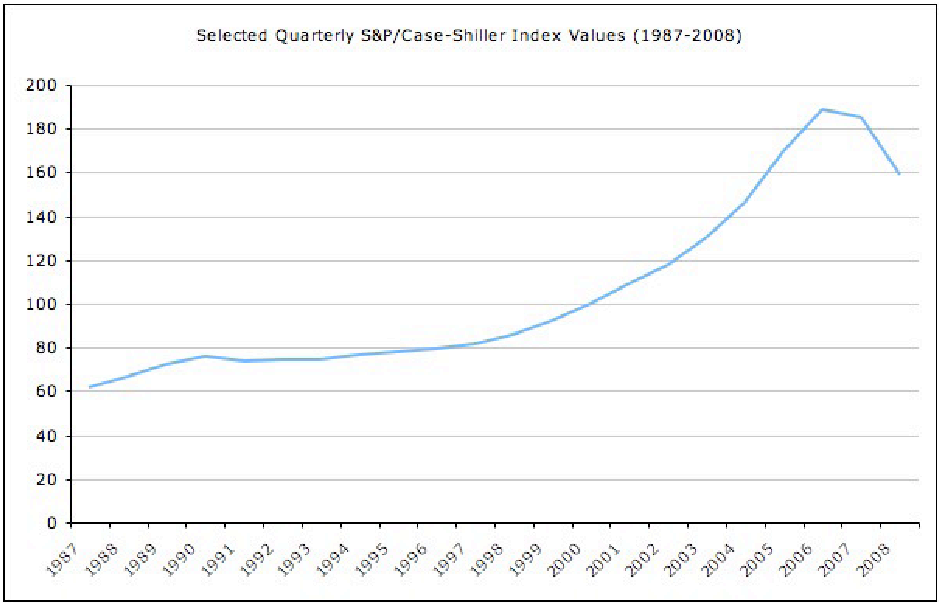

Figure 1 S&P Index showing time series of house prices

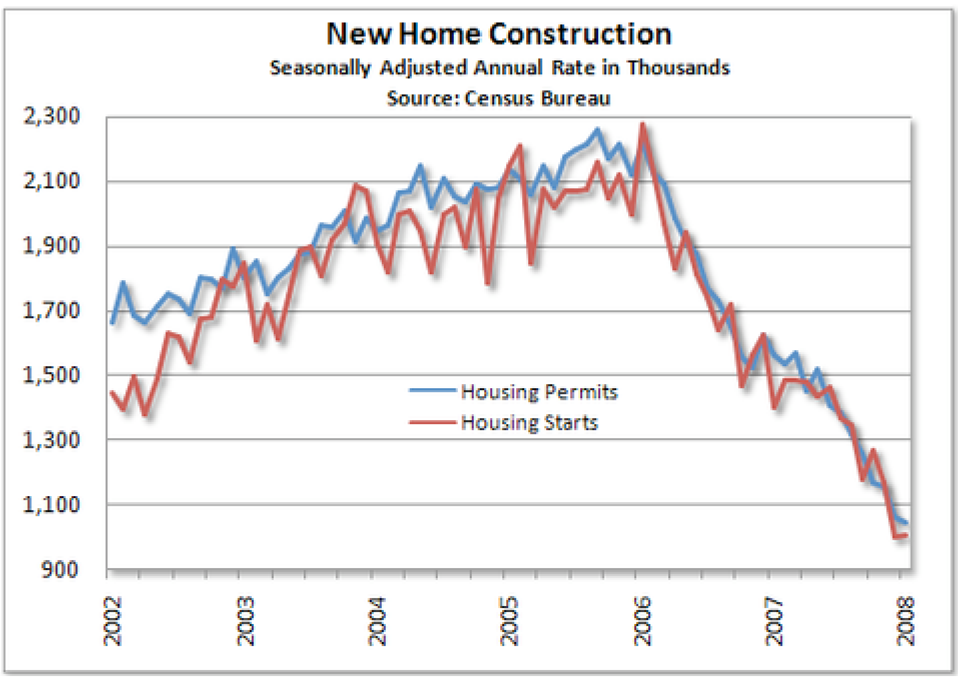

Figure 2 New Home Construction from 2002-2008

The 2008 recession is said to have began many years prior, when various Administrations encouraged widespread home ownership. The Bush Administration followed the same policy, and combined with the low interest rates after the 9/11 terrorist attacks to encourage spending, American consumption was at an all-time high, including in the housing market.

Americans began purchasing homes at an increasing rate. While house prices skyrocketed, construction on new homes increased at a rate almost too fast to meet demand. Realtors and home-sellers were optimistic of the rapidly expanding house market, instead of being wary of an imminent housing bubble.

Increased lending to subprime borrowers, who began to default on their home loans after the house price bubble, worsened the economy. Many of these borrowers were enticed by "teaser" variable interest rates that were low for the first year or two and would then drastically increase. "Teaser" low interest rates, encouragement to increase home ownership, and "pressure" for making a substantial commission influenced lenders to categorize each mortgage package with an inappropriate rating. Say, for example, for a mortgage-backed security (MBS), the underlying loans had a rating of BB, which is much more risky than loans rated AAA. However, credit lenders would rate the package as AAA. [2] Investors were willing to pay more for a MBS that is a lower risk. Inaccurately rating a MBS meant more profit, while the holders of mortgage-backed securities carried a larger risk.

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[2] "[MBS] represents a pool of mortgages that have been securitized, which means they have been packaged by a securities firm into bonds that are sold to investors…as debtors pay off their underlying loans, the money is passed to the bondholders. However mortgage payments come in late or not at all. When mortgaged-backed bonds are packaged by private issuers, their credit quality varies, and some may expose you to more risk." (Standard and Poor's guide to money and investing By Virginia B. Morris, Kenneth M. Morris).

Mortgage-backed securities are owned by many different entities in the financial market, such as investment firms and the US government. When private lenders categorized a risky mortgage as relatively safe, they were essentially overpricing the bond unbeknownst to the holder. When subprime borrowers began defaulting on their home loans at an increasing rate, the consequence was particularly heavy on investment banks.

As the value of MBSs started declining, it was more difficult for investment banks to raise capital. Firms lost interest in engaging with investment banks that were, at this point, considered to be at high-risk of defaulting on their obligations. By the time one the largest investment banks, Lehman Brothers, was denied a bailout from the government in 2008 and declared bankruptcy, the US had already entered a recession. The shaky financial market induced the recession, and had serious repercussions for countries around the world (see *Timeline: U.S. Credit Crunch & Financial Failures* for a more detailed description of the US Recession).

How the US Recession Contributed to the "Great Trade Collapse"

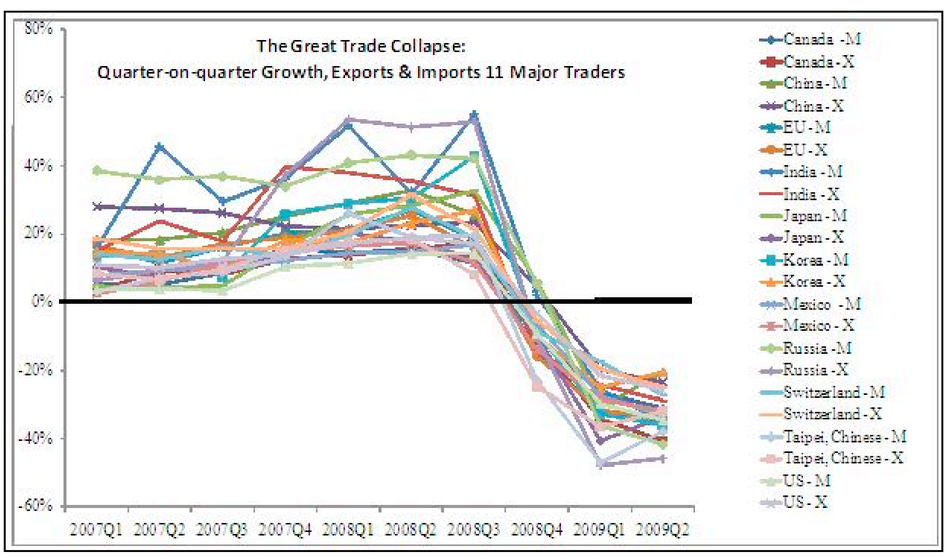

Figure 3 Sources: WTO Online Database, reprinted by Baldwin 2009.

Not since World War II have the rates of trade contraction been so high. Though in absolute terms, the trade collapse of 2008-2009 may not be the similar to the decrease in trade that occurred after the Great Depression, there is evidence that the rate of global trade contraction between 2008 and 2009 was the steepest and fastest on record (Baldwin, 2009). Baldwin notes that the growing consensus among economists on what caused the trade collapse was the decline in commodity prices and the international response to the fall of Lehman Brothers. Commodity prices fell months before the global recession, negatively affecting countries such as Australia that base their exports on commodity goods. In addition, the fall of Lehman Brothers served as a global indicator that the US financial market was unstable. The fear of which was further fortified by the fall of many other US banks. Baldwin suggests that foreign companies and domestic firms lost faith in the G7's financial markets because of the inconsistent decisions made by the US government in resolving the crisis.

One of the major characteristics differentiating the current trade contraction from previous declines in trade is the existence of global supply chains. Baldwin notes that the transmission of information has exponentially increased due to the Internet. When leading economic indicators, such as a decline in consumption or an impending financial crisis, suggest a declining economy, many risk-averse firms instantaneously stop production. As part of a global supply chain, firms in different countries that work on various components of one product will also stop production.

Baldwin does note that protectionism is not a major cause of the Great Trade Collapse:

> While many measures have been put in place – on average, one G20 government has broken its no-protection pledge every other day since November 2008 – they do not yet cover a substantial fraction of world trade. Protection, in short, has not been a major cause of the trade collapse so far (2009, 21).

Economists suggest that the Great Trade Collapse reached its worst point towards the end of 2009 and will begin to recover this year. Patrick Low, an economist for the WTO, says that trading will return to same level as 2007 by the end of 2010. Still, the Director-General of the WTO, Lamy, warns that the risk of protectionism will remain due to the "violence and shock of the downturn" (Freedman and Giles, 2010).

Director-General Lamy is correct to a certain extent. In 2009, there was a 29.5 increase in import restrictions under trade remedy laws. At 76.9 percent, most of the countries initiating investigations to use trade remedies were developing countries (Bown, 2010). Still, between September 2009 and February 2010, these protectionist measures affected only 0.4 percent of world trade imports, which is down from 0.8 percent of the year 2008 (Miller, 2010).

WTO economists are optimistic that the global economy will recover, and believe that the multilateral trading system has been effective in deterring countries from resorting to hasty protectionist measures. This is in stark contrast to the overall sentiment in the US Congress.

III. PROTECTIONIST AND TRADE EXPANSIONARY MEASURES IN THE UNITED STATES

In the US, protectionist measures are evident despite the forecasts of the recovering domestic economy. With the daunting struggle of keeping the domestic industries strong, many members of Congress are in favor of protectionist measures.

One measure deemed protectionist is inclusion of the "Buy American" provision in the fiscal stimulus bill *American Recovery and Reinvestment Act of 2009*. Government procurement is a point of contention between WTO members, and is generally seen as unacceptable to the multilateral trading system. President Obama was opposed to including the provision, stating to members of Congress that a “Buy American” provision is a "potential source of trade wars that we can't afford at a time when trade is sinking all across the globe" (Gesser, 2010).

Another protectionist measure resulting from the recovery is the government bailout of various industries, such as General Motors. With the government subsidizing General Motors, the government is making it more difficult for foreign firms with a comparative advantage in the auto industry to compete. This is reminiscent of the early 1980s when the US government imposed a voluntary export restriction (VER) with Japan, limiting the imports of automobiles from Japan to allow domestic automobile manufacturers to remain competitive (*Concise Encyclopedia of Economics,* Bhagwati).

Aside from subsidizing American car manufacturers, the recession has once again allowed Congress to target countries that prove to be too much competition for American manufacturing firms.

Signs of a Trade War: A Case-Study of the US Trade Relationship with China

Beghin and Kherallah and Beghin (1998) make a prediction in their paper that the US will target developing countries in Asia. The countries in Asia, they mention, were expected to grow by utilizing their comparative advantage in labor, and eventually become competition for America’s declining manufacturing industry. Beghin and Kherallah were correct, as now China serves as the main threat to growth in the manufacturing sector.

Manufacturing firms in the US have labeled China as a rogue member of the WTO, often pointing to China’s state-owned firms and the government’s innate role in the expansion of its economy. The US is not alone in blaming China’s growth to artificial and manipulated factors. In

2008, China was the target of 73 anti-dumping cases brought to the WTO, with entities such as the European Zone and India following the lead of the US in targeting China (Stevenson, 2009). Since 1995, China has remained the number one target of antidumping investigations, with a grand total of 677 anti-dumping investigations. In terms of countervailing duties, China is also the number one target for investigations (Stevenson, 2009). Some economists contend that China will remain a target of trade remedies, so long as China expands while other countries contract during the recession.

Despite the global recession, China is one of the few countries experiencing growth, currently at a rate of 8.7 percent, which is down from 9.6 percent in 2008 (*Economist*, April 2010). In terms of trade, exports account for 24.5 percent of its GDP. However, the figures can be misleading in measuring the actual economic expansion of China in relations to its exports. The *Economist* (April 2010) shows that exports have contributed to only one-tenth of China's growth, and, in general exports have fallen since 2007 and are expected to continue falling as Chinese citizens increase their domestic consumption.

A consensus among members of Congress is that China is having an export-led success because of its artificially depressed currency (see, e.g. Bradsher, 2010). They argue that China's government is buying more foreign currency and selling their own to purposely depreciate the RMB at the expense of the US, and further accusing China of being the ultimate cause of the recession. Many politicians have taken a strong stance against China by demanding that the Chinese government allow the RMB to appreciate in order to lessen the US trade deficit.

When President Obama was a presidential candidate for the Democratic Party, he took a definitive stance on US-China trade relations, and supported protectionist measures to correct for China's wrongdoing. Since winning the election, however, President Obama has maintained a more neutral stance, hoping that talks with China could be the means of reaching a compromise. In fact, the 600-page report published by the USTR in investigating unfair trade practices does not reference China manipulating their currency (*Reuters*, March 2010). The Administration's position also illustrates the cumbersome reality that China owns much of the US national debt, and that the US would ultimately suffer from a trade war with China.[3]

Still, compromise is not what many of the proponents of taking action against China recommend. Many feel that the President's administration is not doing enough to hold China accountable, such as Alan Specter (D-PA) whose speech to the US Steelworkers said:

> For many years now, American steel workers have had to compete in a world that preaches free trade but very often practices illegal trade…China is guilty of international banditry. China violates our trade laws with impunity, robs American workers of their jobs, takes our money and lends it back and now owns a big part of America (Press Release, April 2010).

As an attempt to hold China accountable for manipulating its currency, five senators introduced a bill in March 2010 titled the Currency Exchange Rate Oversight Reform Act of 2010. The bill is a response by politicians that have felt the Administration is too lenient in determining China as a currency manipulator (Grover, 2010). This aggressive measure demands that the US Treasury Secretary, Tim F. Geithner, take a more proactive role in determining whether a currency is being manipulated and allows for a stronger reprimand from the United States if a country fails to realign its currency. Also, following in the steps of the Senate, 130 House members signed a letter urging the Treasury secretary and the Commerce Department to begin taking action against China to protect US manufacturers.

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[3] The US Treasury sells US securities to foreign central banks in order to finance the US government spending and consumer debt. As of March 2010, China holds $1.2 trillion in US government debt (Dickson, 2010).

In support of action against China, Senator Charles Schumer (D-NY), a leading sponsor of the bill, has argued that the trade deficit caused by China cost 2.4 million American jobs between 2001 and 2008 (Grover, 2010).

The figure of 2.4 million jobs lost because of China is taken from the Economic Policy Institute that uses the quantity of Chinese imports to measure the overall job loss. However, this study is notoriously known to overstate the amount of imports by failing to include only the real added value of Chinese production (Ikenson, 2010). For example, a study by Linden, Kraemer and Dedrick (2007) shows that only $4 of every $150 that an iPod costs is value-added from China. However, the study from the Economic Policy Institute includes the total import from China as $150 because, after being assembled in China, the US imports the iPod.

As of this year, tariffs against China have been enacted to protect job loss in industries that are in competition with China. For example, an 18 percent tariff on tires from China was implemented at the urging of both Democrat and Republican representatives arguing on behalf of United Steelworkers union that the low price of tires had claimed US jobs. Other antidumping measures against China are being investigated in the sale of electric blankets, iron, steel, paper, oil pipe, and metal wire (McCue, 2010).

Despite the worries of Congress, economist Joseph Stiglitz says a trade war with China will not benefit either country in the long run. Stiglitz notes that the United States may unfairly blame China for the US trade deficit only because it is the biggest source of competition. As Stiglitz states:

> Saudi Arabia also has a bilateral and multilateral surplus: Americans want its oil and Saudis want fewer US products. Even in absolute value, Saudi Arabia's multilateral merchandise surplus of $212 billion in 2008 dwarfs China's $175 billion surplus. As a percentage of GDP, Saudi Arabia's current-account surplus, at 11.5% of GDP, is more than twice that of China (2010).

Moreover, some politicians do not consider that the large US trade deficit can be attributed to factors other than the exchange rate, such as the low national savings rate and the government deficit (Stiglitz, 2010). The United States is a consumer-oriented country that has been characterized by "over consumption" due to the wide availability of credit and massive consumer debt, which is in contrast to China's high savings and relatively lower consumption rate. Furthermore, China's endowment of labor allows firms that export to sustain low wages and keep their business open. The low-cost goods produced by these firms are especially beneficial in the recession as more Americans are demanding low-cost and low-quality goods.

Nevertheless, there is evidence indicating that China's currency is under-valued and that the government has an integral role in its export success. Using the Balassa-Samuelson model, Frankel (2006) shows that at China's growth rate, China's real exchange rate is not at the level it should to be. Frankel says that according to the model, the RMB is under-valued by 40 percent and states that the RMB should be appreciating. A less technical measure of currency devaluation, but often cited as a relatively accurate, is the Big Mac index. According to the *Economist*, the RMB is close to 50% under-valued against the US dollar.

Moreover, the largest of the state-owned firms received the highest amounts of the Chinese government's stimulus spending through its banks. China depends on these firms to maintain jobs in the export market, thus maintaining its current account surplus *(Economist, 2010*).

However, if China were to allow the RMB to appreciate, the effect would be small in terms of reducing the US trade deficit and may actually worsen the situation in the United States. The *Economist* (March 2010) notes that by allowing the RMB to appreciate, the effect will be limited to the real competitiveness of China's industries. Moreover, the increased price of

Chinese goods will have an effect on certain groups of producers and consumers in the US. Allowing the RMB to appreciate would increase the costs of Chinese exports, which the US, to a certain extent, relies on. Large retailers, such as Wal-Mart, use a significant quantity of Chinese goods. Many customers at these retailers are low-income to middle-income households. Therefore, tariffs on Chinese goods will serve as a regressive tax (Ikenson, 2010).

One must also note that China, in comparison to other emerging economies, practices fewer acts of protectionism with an average applied tariff of 9.6 percent in 2008. India, for example, surpasses this amount with their average applied tariff of 13 percent. Nevertheless, America has a more open economy than China, with an average applied tariff of only 3.8 percent (*Economist*, April 2010).

Congress' fear that China may be the nemesis of free trade is exaggerated. Yet, concerns about protectionism are not unfounded. Many indicators point to there being more that China can do to ensure freer trade, but the same can be said for the United States. Free-trade supporter Bergsten has advised the Administration to utilize the legal mechanism of the WTO, instead of the International Monetary Fund that overlooks foreign exchange policies, to persuade the Chinese government to allow its currency to appreciate, even at the expense of a political battle (*Wall Street Journal*, 2010). However, what Bergsten suggests and Congress' method of targeting and blaming China for the US recession is unproductive, and will lead to an inevitable trade war. If China were to allow the RMB to appreciate, it will do so on its own terms and not under the spotlight placed on it by the US. Also when they do, the US will still find that there will be little change to the current account deficit and that the effects of the recession will not disappear.

The Congressional Solution to "Unfair" Trade

As identified in this paper, along with various other studies, the role of Congress in determining trade policy becomes more critical and invasive in times of an economic downturn. Trade policy will likely be a controversial issue in the upcoming Congressional mid-term elections, and tensions with foreign countries, including China, will be at the forefront of debates.

Currently, Congress seeks a more important role in determining trade legislation; a role that was diminished after Roosevelt passed the Reciprocal Trade Act. Trade legislation ever since has highlighted the Administration's role in determining trade negotiations, trade expansion, and trade protection. Section 301, however, was a major step in allowing an Administration to act in a more biased manner towards domestic industries, and in turn towards political sway. During the current recession, trade bills that have been introduced in the Senate and House are far more assertive and insistent on including Congress in trade negotiations than ever before. Some bills demand outright that the Administration no longer have the dominant role, outlining steps for Congress to have the final say on trade policy.

The Currency Act is only one bill of many introduced in Congress that places more pressure on the Administration and that aims to reclaim the role of Congress in determining trade policy. One other major bill, the first draft of which was introduced in 2008 and amended in 2010, is the TRADE Act.

The TRADE Act, introduced in both the Senate and the House, is a drastic measure that:

> Mandates reviews of all international trade agreements currently in force, establish new standards and requirements for future trade agreements, require new labor standards, and impose higher congressional oversight for any trade agreements (*Global Trade Watch,* 2009).

The TRADE Act aims to repair the "damage" previous trade negotiations may have imposed on less competitive industries, such as the agricultural and manufacturing sector. Moreover, there is a clause that provides continued subsidies for the agricultural sector, despite proposals to decrease agricultural subsidies in the Doha Round. Future trade negotiations under this Act will also keep the agricultural and manufacturing industry at the forefront of benefits by enforcing environmental and labor regulations. Failing to oblige may mean US withdrawal from the trade agreement or the US imposing trade sanctions. By demanding such regulations on emerging economies that are labor-intensive, American manufacturing firms can more easily opt for trade remedies whenever trade partners fail to abide.

The time process of establishing trade negotiations under the TRADE Act will be lengthened because of a clause removing Presidential Trade Promotion Authority, or what is often referred to as fast track. Fast track allows the President to establish trade negotiations without much input from Congress, and under a much shorter time span. Congress members are able to vote on the trade agreements proposed by the Administration, but cannot amend clauses in the trade negotiation.

One of the most potentially detrimental features of the TRADE Act is removing aspects that are conducive to the WTO and undoing the intent of the multilateral trading system of expanding trade. For example, there is a provision that authorizes the use of "Buy American" stipulations in future multilateral and bilateral trade negotiations, despite future negotiations made under the Doha Round and the WTO.

This bill has over 140 bipartisan supporters in the House and Senate. Though bipartisan, Democrats are more in favor of the TRADE Act than Republicans.

The TRADE Act is the leading bill aimed at reforming trade policy to include Congressional oversight. On January 14, 2009, Rep. Charles Rangel (D-NY) and Sander Levin (D-MI) introduced the Trade Enforcement Act along with 9 other sponsors. The Trade Enforcement Act is similar to the TRADE bill but less extreme (*Global Trade Alert*, 2010). Also, on March 2, 2010, Gene Taylor (D-MO) introduced H.R. 4759, which mandates the withdrawal of the United States from NAFTA.

These bills combined reflect a skewed belief in Congress that the costs of free trade weigh heavily on domestic industry, though trade theory shows that freer trade leads to improved national welfare. Congress is attempting to undo the measures and intent of the Reciprocal Trade Act of 1934, transferring authority from the President to Congress through the TRADE Act. Furthermore, Congress is ensuring that the multilateral trading system takes a backseat to the concerns of the domestic industry.

Congress' increased input through these bills will permanently place "political sway" in the formulation of future trade policy measures. By passing the TRADE Act, the US will fall into an era similar to that of the Great Depression, in which high made-to-order tariffs further worsened the recession. Though there are those who claim that the bills will not be passed, one must heed the cautionary tale of trade in the 1970s. The Trade Act of 1974, created in the already established multilateral trading system under the auspices of the GATT, shows the impact a recession has on trade policy. Despite a multilateral trading system, the US established Section 301 to allow independent and unilateral decisions on trade matters, and as a way for American business to remain dominant during a global recession.

President Obama's Trade Policy

Although Congress is a Democratic majority led by Democratic President Obama, trade policy is an issue in which Congress and the President have different approaches. President Obama's trade policy is relayed through the USTR, Ron Kirk. On March 1, 2010 Kirk released the President's 2010 Trade Policy Agenda titled *Making Trade Work for America's Working Families*. Reading this Agenda, one finds the evident struggle between making free trade policy among a recession with high unemployment and the public's fears that trade may cost jobs. The title alone alludes to the concern that the US has with foreign labor and how trade negotiations have yet to satisfy America's bottom line. President Obama has publicly declared that his administration will remain strongly committed to the WTO and completing the Doha Round. Though, his commitment to Doha is second to strengthening the domestic economy. About 40 percent of Americans say that trade agreements benefit the U.S. economy, according to Drajem (2010). President Obama's policy, then, is a clear illustration of seeking a balance of free trade, while appeasing the American public and Congress who are currently favoring less foreign trade.

Foreign labor is a significant concern in the President's agenda for 2010, conveyed through the rhetoric of enforcing labor standards and human rights protection with trade partners.

> Over the last year, we also instituted more vigorous scrutiny of foreign labor practices and began to redress practices that impinge upon labor obligations in our trade agreements, deny foreign workers their internationally recognized rights, and tilt the playing field away from American workers (Trade Policy Agenda).

The Trade Agenda is particularly keen on establishing oversight and regulation with countries that are in competition with US industries, including China.

Moreover, the Trade Agenda demands more regulation of environmental practices, and has established a subcommittee of the Trade Policy Staff Committee whose sole responsibility is ensuring that Free Trade Agreement partners comply with the environmental standards.

One major pursuit in future multilateral and bilateral trade negotiations is the protection of intellectual property, the protection of which is considered insufficient under the WTO even with the Trade-Related Aspects of Intellectual Property Rights (TRIPS). The Agenda notes that without protection of intellectual property, multilateral trading is undermining the United States' comparative advantage in "innovation and creativity." The US will seek negotiations that increase trade liberalization in this field, but as long as trade partners implement intellectual property rights.

Though the US demands more regulation of labor practices, the environment and intellectual property, the US criticizes the food regulation standards and sanitary standards of other countries that "obstruct" trade. Therefore, it is evident that President Obama also seeks to reinforce America's dominance in the global market.

Still, despite using regulations as a non-tariff barrier to trade, President Obama will attempt to expand trade through various programs, such as removing special interest groups from the formulation of trade policy, establishing trade with the Asian-Pacific countries, and by establishing the Export Initiative. However, the Export Initiative been criticized by many economists as an impracticable measure that will not be fulfilled for at least another ten years. First, the shift would require that national savings increase substantially, which would be difficult for a high-consumption country to gravitate towards. Next, firms will have to sell products that are in high demand overseas, which is not the case. Robert Kuttner was quoted in the *Economist* (March 31, 2010) stating, "There are just too many products that we no longer make and too many foreign links in the industrial supply chain." In the same article, it is mentioned that the increase in exports can only come from firms that use "sophisticated, knowledge-intensive capital goods like microprocessors, and high-end services like engineering".

Trade in services, which is America's current comparative advantage, contracted at a smaller rate than other goods in the Great Trade Collapse, and has had positive growth since the fall. The fact that President Obama has included the protection of the service industry from trade competition under the Trade Adjustment Assistance (TAA) demonstrates that the US recognizes the integral shift in US comparative advantage.

Despite Congress' attempt in limiting the role of the multilateral trading system, President Obama has affirmed commitment to utilizing the "rule-based trade system anchored by the WTO" and further highlights how successful trade remedy measures were taken against China legally under the WTO. This is a positive sign that the Administration views the WTO effective in settling trade disputes.

IV. THE DOHA ROUND AND US LEADERSHIP

The Doha Round of multilateral trade negotiations started in 2001, and has since been recognized as an unsuccessful attempt to improving the multilateral trading system. Though Director-General Lamy remains optimistic that the talks are "worth the effort", the intense divide between developed and developing countries, says otherwise.

The Doha Round is taking place within a transformation in international trade. Developed countries are shifting from predominantly manufacturing-based economies to service economies that best utilize the high-skill labor and high-technology capital endowments of these countries. Emerging economies are evolving from agrarian-based economies to manufacturing, whereas developing countries are increasingly opening their economies through their agricultural sectors.

The implication of this transformation is significant in explaining why the Doha Round is deadlocked.

When the GATT was created in 1947, only 23 countries were signatories, most developed and emerging economies. According to Collier (2006), the GATT was signed by major developed and emerging economies that could benefit from the decrease in manufacturing tariffs. He further mentions that the US, EU and Japan were gaining economic momentum after the GATT as large trading partners. The benefits of the GATT were clear in allowing the reduction of tariff barriers for years thereafter. At present, with 153 countries at various stages of economic development aiming for full integration in the WTO, the disagreements are large enough to hinder more progressive steps towards freer world trade. The trade relationships between developed, emerging and developing economies are resulting in clashes over issues such as agriculture and regulations relating to labor and the environment.

The US and the EU provide the most protection for their agricultural sector through government-funded subsidies. According to the CIA World Fact Book, the agricultural sector of the United States comprises only 1.2 percent of GDP and employs only 2 million people, and the European Union’s agricultural sector contributes to only 2 percent of GDP. Yet, over $48 billion is spent on direct government payments, and 40 percent to 50 percent of all EU spending goes towards subsidizing the farming industry under the Common Agricultural Policy (CAP) (Godfrey, 2002). These measures impose great limitations on developing countries that seek to open their economies. Often, the surplus commodities from EU firms and US firms are sold at a much lower rate on the world market, which can damage a developing countries’ domestic economy for at least a couple of years. Developing countries therefore contend that tariffs be applied to their domestic industries, in order that they to adjust to the effects of trade for at least the first few years as members of the WTO. Some countries argue that these tariffs be as high as 100 percent.

The Obama Administration has agreed to reduce trade barriers in the agricultural sector from $48 billion to $15 billion so that there is some compromise. Though the number may seem slight in absolute terms, the attempt is significant. Reducing subsidies in the agricultural sector has been attempted in the past by different presidents, but have been unsuccessful. The removal of subsidies is difficult because of the politics surrounding the protection of the agricultural sector. Agricultural lobbyists are often aggressive in insuring that the sector continues receiving subsidies, despite the negative affect on developing countries and increasing prices of agricultural commodities in the US.

For there to be any progress in removing subsidies from the agricultural sector, developed countries, not the US alone, must make a commitment to at least reduce agricultural subsidies so that developing countries are not so adversely affected. This will reduce the incentives for developing countries to impose tariffs on agricultural commodities.

Though the US may not give into wishes of developing countries, it raises strict demands that may be impossible for developing countries to follow. As mentioned earlier in this paper, the US Congress is pressing to include strict regulations on labor and environmental standards. Some economists, including Collier, suggest that such measures are protectionist and impose an artificial trade advantage on the behalf of the US. Developing countries and emerging economies are not at a stage where they can afford environmental and labor regulations, and attempting to impose these regulations would be costly as well as time consuming. Studies have identified that the best means of obtaining higher standards in labor and environmental protection is through economic development. Many current developed economies experienced increases in pollution and weak labor protection when industrializing their economies, and developing countries in the modern era are no exception. Tariffs and imposing trade sanctions on these developing economies that have lower standards will not be fruitful. A better approach is through technology transfers; developed economies can help developing countries ascertain higher environmental and labor standards when developing countries have the right tools. However, it is difficult to change the intrinsic structure of a developing country's economy; a labor-intensive country will most have often have less human rights protection.

Environmental and labor regulations within Free Trade Agreements and through the Doha Round are seen as a direct measure to marginalize developing countries and impede their economic growth. Unfortunately, President Obama remains aligned with Congress on this matter stating that he hopes to see these regulations on future trade negotiations, without urging a more effective mechanism in assisting developing countries and trade partners to achieve these unfeasible regulations.

Regrettably, the future of trade negotiations, both bilateral and multilateral, rests on whether or not the US finds an upper-hand advantage without compromise. Congress' attempts in formulating legislation that will impose stricter regulations, diminish the importance of the WTO in settling trade disputes, and that are without compromise on removing trade barriers, such as the "Buy American" provision and protection of agricultural subsidies, demonstrates a political fear for the future of America's position in the world. A free trade mantra is now perceived as inflicting a wound on the strength of America's economy, as countries, such as China, continue rising in strength. The erratic attempts by politicians in Congress to induce protectionist provisions in future trade negotiations is an unfortunate consequence, and will therefore forever change the face of the multilateral trading system. That is, unless the following recommendations are approached.

Recommendations

It is without saying that allowing Congress to gain complete oversight of US trade policy will be detrimental to trade itself. The Reciprocal Trade Act, the GATT and the WTO are all measures that sought the removal of politics from the multilateral trading system, which would allow for the best means of reaching a world of free trade. The history of US trade legislation demonstrates that President Obama has the ability of ensuring free trade, through his actions and through his rhetoric.

If the TRADE Act and other bills similar to it pass in Congress, President Obama must resort to his veto power to stop the bill from becoming legislation. Even with slight revisions, these bills have several measures that are protectionist and should not be allowed under the WTO rules.

By supporting environmental and labor regulations, however, President Obama is also supporting protectionism. Though he calls for a better global environment through the use of clean and alternative energy, limiting carbon emissions, etc., his efforts are best concentrated in the US and other developed countries.

US leadership within the Doha Round is essential to encouraging further trade negotiations between developed and developing countries. Though reducing agricultural subsidies will be difficult, President Obama must keep his promise to the developing countries. Subsidies on cotton were deemed illegal after Brazil presented its case against the US in the WTO. Subsidies on other agricultural goods, such as rice, should be no different in being deemed illegal. It is only a matter of time when other countries, with enough resources, present a case against the agricultural subsidies in the US.

Conclusion

The GATT and the WTO were formed as result of the grave repercussions of the global trade war in the 1930s. After the Great Depression, it was finally apparent that when a country aims solely towards strengthening its domestic economy, in the end they will shut themselves out from the benefits of a global economy. With a country as large and economically powerful as the United States, the impact of the political decisions can infiltrate many countries around the world. This story rings true today, as we find that all countries are shaken by the financial crisis in the US.

Many will have to cope with the uncertainty that abounds while recovering from a recession. The US is in position of adjustment, and with change there is looming fear. Farmers, teachers, doctors, investment bankers, and other citizens will be learning that the “over consumption” that has defined America for many years can no longer be sustained. The Administration and Congress, in demanding that China allow their currency to appreciate and establishing the Export Initiative, is positioning the US for a fundamental shift from a debtor country to a creditor country. Though the transition is a far reach and can only be obtained after some time, such a shift will influential for the US’s trade position and future trade negotiations.

Abroad, we find that other countries are in the same dilemma, but with an additional worry. Developed and developing countries alike are now questioning if a strong reliance on the United States will mean another recession that is out of their control. They too want to strengthen their domestic economies, and for some that may mean reducing the impact of a global recession by diversifying their relationships with other trade partners.

The reality, however, is that the US for some time will continue as the world's largest economy. For this reason, America's position on trade and the multilateral trading system is significant. While countries are keeping a keen eye on America's recovery, now is the opportune time for the US to display a commitment to trade.

Though members of Congress are attempting to undo the strength of the multilateral trading system, it is still the case that the President has the ability to persuade his constituents that trade works in favor of the American citizen. The President can urge members of Congress to reach a compromise with trading partners, rather than applying stricter barriers to trade. But, most importantly, he must be seen as the leading advocate for freer trade and for progress in the current Doha Round.

To some extent, President Obama's policies on trade are not as protectionist as studies would predict. Yet, we find that there is little solid effort in expanding trade. President Obama's approach to trade demonstrates a reluctance that free trade will be considered favorable by the American public, and especially the unions that have strongly aligned in favor of his election. He will risk the chance of the union vote, which may also affect his chances of re-election. But, President Obama ought to heed the lessons of the past when he takes the next few steps in trade policy, and remain cautious of the recourse taken by members of Congress.

Though centuries have passed since Adam Smith outlined the then radical idea that free trade benefits all countries that engage in it, we find the ominous warning that many studies, some of which are presented in this paper, also conclude. Smith warns:

> To judge whether [tariff] retaliations are likely to produce such an effect, does not, perhaps, belong so much to the science of a legislator, whose deliberations ought to be

> governed by general principles which are always the same, as to the skill of that insidious and crafty animal, vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs (204-205).

The true nemesis of free trade is not China or the developing countries, or any other country reaching an "unfair" trade advantage. The greatest threat is a politician, who acts on behalf of a constituent, but can overall be persuaded by a rent-seeking lobbyist that is able to pay for his or her campaign.

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